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IN THE

Supreme Court of the United States

October Term, 1978
No. 78-182

O. E. SERWOLD and HELEN SERWOLD, his wife,

Petitioners,

vs.

KENNETH N. NELSON,

Respondent.

On Petition for Writs of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Motion for Leave to File Brief Amicus Curiae of Stephen W. Holohan in Support of the Respondent Kenneth N. Nelson and Brief Amicus Curiae of Stephen W. Holohan.

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On Petition for Writs of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Motion of Stephen W. Holohan for Leave to File Brief Amicus Curiae.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Stephen W. Holohan respectfully moves this Court, pursuant to Supreme Court Rule 42(1), for leave to file the accompanying brief in this matter as amicus curiae in support of the Respondent, Kenneth Nelson. In support of this motion, Stephen W. Holohan shows as follows:

1. The parties in this action have not been contacted relative to consent because the time allowed for the filing of the brief of the party supported has expired.

2. While the brief is submitted late, it is requested that the motion for leave to file brief amicus curiae be granted for the following reasons:

a. The cases and literature screened by amicus curiae indicate general acceptance of the decision in *Affiliated Ute Citizens v. United States*. The amicus curiae brief questions the soundness of that decision.

b. The deceit frame of reference endorsed by *Affiliated Ute* clouds those prohibitions of Rule 10b-5 dealing with other than deceit. Consequently, notions of recklessness that are unrelated to deceit or to the "omissions"-"deceit" concepts of *Affiliated Ute* have been obscured. This brief outlines those notions.

3. Stephen W. Holohan is a Los Angeles attorney, who is a plaintiff's attorney in a Rule 10b-5 litigation in the Central District of California, which involves recklessness issues.

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BRIEF AMICUS CURIAE OF STEPHEN W. HOLOHAN.

INTEREST OF THE AMICUS.

The interest of the amicus is to ascertain the definition of recklessness relative to Rule 10b-5 matters.

INTRODUCTION AND SUMMARY OF ARGUMENT.

Recklessness has been utilized as a standard of culpability in Rule 10b-5 decisions. The definitions which have been used, fall into two categories: (1) reckless disregard for the truth, and (2) reckless conduct in omissions cases.

The purpose of this brief is to demonstrate:

1. That Rule 10b-5 prohibits conduct classifiable as either fraud or deceit, but not just omissions. Classifying conduct as an omission dissolves the express distinction between fraud and deceit set up in the prohibitive clauses of the rule.
2. That if item (1) is correct, then the categories of recklessness become (1) reckless disregard for the truth, and (2) recklessness as to consequences. This dichotomy harmonizes with the prohibitive clauses of Rule 10b-5, but, coincidentally, requires that each prohibitive clause be treated as an independent basis of liability. If clauses (1) and (3) of the rule are each an independent basis of liability other than deceit, then the elements of each are, therefore, other than the elements of common law deceit.

I
ASSUMPTIONS.

For the purpose of this brief, certain assumptions are made:

1. *Liability for knowing conduct.* In *Ernst & Ernst v. Hochfelder,* 425 U.S. at 197, the Court states:

> Section 10(b) makes unlawful the use or employment of "any manipulative or deceptive device or contrivance" in contravention of Commission rules. The words "manipulative or deceptive" used in conjunction with "device or contrivance" strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct.

This brief assumes that the Supreme Court has determined that liability in Rule 10b-5 matters is to be subjective.

2. *Recklessness: subjective or objective.* In *Ernst & Ernst,* 425 U.S. at 193-194 n. 12, the Court states:

> In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act.

This brief assumes, that while the question of whether recklessness is a proper standard of culpability in Rule 10b-5 matters is open, the question of whether recklessness is a subjective or objective standard is not. In light of the proscription against knowing or intentional misconduct, it is assumed that the Court refers to a subjective concept of culpability.

II
OMISSIONS CASES.

Affiliated Ute reads at 406 U.S. 153-154 as follows:

> To be sure, the second paragraph of this rule specifies the making of an untrue statement of a material fact and the omission to state a material fact.

Rule 10b-5(2) reads in part:

> . . . (t)o omit to state a material fact necessary in order to make the statement made in light of the circumstances under which they were made not misleading.

At common law, this notion was called a half-truth in that if the defendant does speak, he must disclose enough to prevent his words from being misleading. A half-truth is a form of deceit.

In the chapter on Fallacies of Observation in John Stuart Mills, *A System of Logic* (Volume VIII of The Collected Works, University of Toronto Press 1974) at 773 it reads:

> A fallacy of misobservation may be either negative or positive; either Non-observation or Mal-observation. It is non-observation, when all the error consists in overlooking, or neglecting, facts or particulars which ought to have been observed. It is mal-observation, when something is not simply unseen, but seen wrong; when the fact or phenomenon, instead of being recognized for what it is in reality, is mistaken for something else.

The view of this brief is that Rule 10b-5(2) has been misread by the *Affiliated Ute* decision insofar as that decision treats "the omission to state a material

fact" as an independent ground for relief. A corollary view is that the latter part of Rule 10b-5(2) is nothing more or less than the half-truth notion applied to the securities field. The *Affiliated Ute* decision obliquely illustrates this position. *Affiliated Ute Citizens* reads at 406 U.S. 154 as follows:

> The obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact. *Chasins v. Smith, Barney & Co.*, 438 F.2d at 1172.

Chasins at 1172 reads:

> Chasins relied upon Smith, Barney's recommendations of a purchase made without the disclosure of a material fact, purchased the securities recommended, and suffered a loss in their resale. Causation in fact on adequate reliance was sufficiently shown.

Clearly, this passage from *Chasins* evidences a half-truth situation, *i.e.*, recommendations which mislead because of the omission of the material fact. In short, it is a classic deceit case. Moreover, *Chasins* explicitly bases causation in fact on reliance, and not an obligation to disclose and the withholding of a material fact as stated in *Affiliated Ute*.

The consequence of the mal-observation of Rule 10b-5(2) was the oft-cited *Affiliated Ute* passage.

> Under the circumstances, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.

> See *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (CA 2 1968), cert. denied sub nom.; *Coates v. SEC*, 394 U.S. 976 (1969); 6 L. Loss, *Securities Regulation* 3876-3880 (1969 Supp. to 2d ed. of Vol. 3); A. Bromberg, *Securities Law Fraud—SEC Rule 10b-5* §§ 2.6 and 8.6 (1967).

Hence, while the "omission to state a material fact" was severed from its common law deceit antecedents, the decision immediately applied the elements of common law deceit to the freshly minted cause of action for omitting to state a material fact. Consequently, although a deceit was not presented on the facts, the decision held that deceit elements applied. But the decision was not able to apply the deceit elements directly, because inasmuch as there was no statement, there could be no reliance. To skirt this quandary, two fictions were established: (1) reliance was not a prerequisite to recovery, and (2) an obligation to disclose and the withholding of a material fact establish causation in fact.

Professor Fuller states in Legal Fictions, (1967) at 9:

> A fiction is either (1) a statement propounded with a complete or partial consciousness of its falsity, or (2) a false statement recognized as having utility.

The *Affiliated Ute* decision does not indicate which of these two notions may have been the basis for the fictions which the decision established.

Classification of Rule 10b-5 Offenses.

The consequence of the *Affiliated Ute* decision has been the tendency to funnel all claims for relief under Rule 10b-5 into deceit actions, *i.e.*, Rule 10b-5(2) claims.

A fuller excerpt from *Affiliated Ute* reads at 406 U.S. 152-153:

> To be sure, the second subparagraph of this rule specifies the making of an untrue statement of a material fact and the omission to state a material fact. The first and third subparagraphs are not so restricted. These defendants' activities, outlined above, disclose, within the very language of one or the other of those subparagraphs, a "course of business" or a "device, scheme, or artifice" that operated as a fraud upon the Indian sellers. *Superintendent of Insurance v. Bankers Life & Casualty Co., supra.* This is so because the defendants devised a plan and induced the mixed-blood holders of UDC stock to dispose of their shares without disclosing to them material facts that reasonably could have been expected to influence their decisions to sell. The individual defendants, in a distinct sense, were market makers, not only for their personal purchase constituting 8-1/3% of the sales, but from the other sales their activities produced. This being so, they possessed the affirmative duty under the Rule to disclose this fact to the mixed blood sellers. See *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167 (C.A. 2d 1970).

Just as in *Affiliated Ute*, other courts have used the notion of "failure to disclose" to bring the facts of a particular case into a deceit context.

In this case, *Nelson v. Serwold*, 576 F.2d 1332 (9th Cir., 1978), this method is repeated:

> We agree with the district court's findings that the omissions, considered in their entirety, but with particular reference to nondisclosure of the control group and its long-range plan are material within the meaning of Rule 10b-5. (p. 1336.)

Elsewhere, the court stated:

> The existence of a plan to acquire control of Poulsbo Telephone, strengthen and sell it is supported by the facts that the control group set out to acquire a majority of the stock; they ceased affirmative efforts to acquire stock after achieving control; they set out on a plan of modernization; they entertained "feelers" from and negotiated with potential purchasers of the company; and they eventually sold it for a substantial gain. (p. 1336.)

Hence, just as in *Affiliated Ute*, the conduct above could be characterized as being within the first and third subparagraphs of Rule 10b-5, but was not.

III
RECKLESSNESS.

Preliminary Observation.

In *The Mental Element in Crime—A Legislative Problem*, by Remington and Helstad, 1952 Wisc. L. Rev. 644, at 673-675, the problems associated with defining recklessness were discussed. The authors' comments are appropriate in the Rule 10b-5 context, and are therefore excerpted in detail:

> To form a statutory definition of either negligence or recklessness for the purpose of criminal liability is not easy. The conceptual difficulty inherent

in the problem, makes clear and concise statutory formulation, insofar as that is possible, more important in this area than in any other. The present confusion resulting from the inconsistent use of terminology in the statutes alone warrants revision. But more than that can be accomplished. Preliminary to statutory formulation, there should be a policy determination of whether liability is to be objective or subjective. . . . (H)aving made that decision, the basis chosen should be stated as clearly as possible. There are several aspects of the problem:

1. If the basis of liability is to be objective, it is not sufficient to phrase the standard in terms of "negligence" modified by an epithet which serves to put people on warning that ordinary negligence is not sufficient. To stop there would still leave the question of whether liability is to be objective or subjective. . . .

2. In those crimes where a subjective mental state is required, that mental state ought to be clearly defined. It is not enough to use terms like "wilful and wanton". "Wilful" cannot mean what it seems to or the crime would be based on intent. "Wanton" leaves much room for doubt. It may be decided that liability for certain consequences will result if the actor was aware of the circumstances which existed at the time he committed his dangerous act, even though he did not appreciate that he was creating a danger to others. If so, there is no reason why that cannot be clearly stated in the statutory form. On the other hand, it may be decided that liability should not result unless the actor was aware of the fact

that he was creating a risk to the safety of others. If so, that should be stated. There are bound to be difficulties.

Definitions.

Miscellaneous definitions of recklessness have been used in securities law, tort law, and criminal law. A representative sample is outlined below in the following format.

A. Securities Law
   1. Gross negligence
   2. Reckless disregard for the thruth
      a. Subjective standard
      b. Objective standard
   3. Constructive knowledge
   4. Recklessness as to consequence
   5. Distinctions blurred

B. Tort Law
   1. Reckless disregard for the truth
      a. Objective standard
      b. Subjective standard
   2. Recklessness as to consequences
      a. Subjective standard
      b. Objective standard
   3. Substantially certain consequences

C. Criminal Law
   1. Gross negligence
   2. Recklessness as to circumstance
   3. Recklessness as to consequence
   4. Wilful blindness

A. Securities Law.

1. Gross negligence
   a. *Bailey v. Meister Brewing, Inc.*, 535 F.2d 982, 993 (7th Cir., 1976)
      1. While there was no direct knowledge, the court below found that, at the least, Continental and its participating officers and controlled directors

         were grossly negligent in failing to recognize the unfairness of the asset transfer

         and

         blinded by a conflict of interest, wantonly ignore(d) evidence of the unfairness of (the) securities transaction to the corporation and therefore fail(ed) to disclose this evidence to those shareholders whose interests lie with the corporation.

2. Reckless disregard for the truth
   a. Subjective standard
      1. *McLean v. Alexander*, 420 F.Supp. 1057, 1084 (Del., 1976)
         a. There is little reason to distinguish between knowing misbehavior under Section 10(b) and Rule 10b-5. In practice, one who recklessly makes a statement inherently possesses some knowledge of its falsity. The common law, precedent in other fields, and the legislative history of 10

(b) all buttress the viewpoint that 10b-5 liability ought to attach upon a showing of recklessness

3. Constructive knowledge
   a. *SEC v. Frank*, 388 F.2d 486, 489 (2nd Cir., 1968)
      1. If this is so, the Commission would be entitled to prevail; a lawyer, no more than others, can escape liability for fraud by closing his eyes to what he saw and could readily understand.

4. Recklessness as to consequence
   a. Subjective
      1. *SEC v. National Student Marketing Corp.*, 402 F.Supp. 641, 648 (D.C. Cir., 1975)
         1. The traditional view relied on by Katz is that one acting solely as an attorney will not be held in violation of the securities laws as an aider and abettor unless he had actual knowledge or acted in a wilful and reckless disregard of a fraudulent scheme in which he played an essential part.
   b. Objective standard
      1. *Franke v. Midwestern Oklahoma Development Authority*, CCH Fed. Sec. L. Rptr. (1976-1977 Transfer Binder) ¶ 95,786, at 90,846, 90,850 (W.D. Okla., 1976)

a. In the context of an omissions case, reckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable, negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

2. *Sundstrand Corporation v. Sun Chemical Corporation,* CCH Fed. Sec. L. Rptr. (1976-1977 Transfer Binder) ¶ 95,887, at 91,252, 91,260 (7th Cir., 1977)

   a. Indeed the Franke definition of recklessness should be viewed as the functional equivalent of intent (citations omitted) . . . While this definition might not be the conceptual equivalent of intent as a matter of general philosophy, it does serve as a proper legally functional equivalent for intent, because it measures conduct against an external standard which, under the circumstances of a given case, results in the conclusion that the reckless man should bear the risk of his omission (citation omitted). When

measured against this external standard, it may be said that such a reckless man has "use(d) or employ(ed) (a) deceptive device" within Section 10(b).

3. *Continental Assurance Co. v. American Bankshares Corp.,* CCH Fed. Sec. L. Rptr. (1977-1978 Transfer Binder) ¶ 96,274, at 92,764, 92,766 (E.D. Wisc., 1977)

   a. The functional equivalent of intent was found in Sundstrand where the defendant was cognizant of the danger of misleading the plaintiff or the danger was obvious, but nevertheless, acted recklessly or recklessly failed to act in his dealings with plaintiff. The complaint in this case alleges that the defendants knew of the plaintiff's reliance on the representations made by the defendants, or they should have known them to be such. As stated above, the Court finds the allegation of "should have known" sufficient to allow proof of reckless conduct.

(Brief author's note: These definitions together with Professor Prosser's are in part objective and in part subjective. The reason for classifying as objective is that the emphasis in the definition is on an external standard (Sundstrand) and the emphasis

on "highly unreasonable omission" (Franke).

4. Distinctions blurred

a. Ruder, D. S., *Factors Determining the Degree of Culpability Necessary for Violation of the Federal Securities Laws in Information Transmission Cases,* 32 Washington & Lee L. Rev. 571 (1975)

1. Reckless conduct exists when the defendant acts in conscious disregard of, or indifference to, the risks that others will be misled. This conduct includes what is sometimes referred to as "gross negligence."

b. Bromberg, *Securities Law: Fraud,* Sec. 8.4(572), pp. 208-209

1. Recklessness has no precise relationship to actual knowledge and constructive knowledge. Sometimes it is treated as an alternative to constructive knowledge . . . (T)he actor's possession of actual knowledge of truth or incompleteness of information will naturally enhance the probability that he will be found reckless

(and held liable) in making representations or omissions of the information.

c. *Shemtob v. Shearson, Hammill & Co.,* 448 F.2d 442, 445 (2nd Cir., 1971)

1. Thus plaintiffs' claim is nothing more than a garden variety customer's suit against a broker for breach of contract, which cannot be bootstrapped into an alleged violation of § 10(b) of the Exchange Act, or Rule 10b-5, in the absence of an allegation amounting to scienter, intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme or artifice to defraud.

d. *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 194, 47 L.Ed.2d 668, 677, 96 S. Ct. 1375, 1381 at n. 12.

1. In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act.

B. Tort Law.

1. Reckless disregard for the truth
   a. Objective standard
      1. *Holmes, O., The Common Law* (1881) at 109
         a. Now what does "recklessly" mean. . . . It means only that the data for the statement were so far insufficient that a prudent man could not have made it without leading to the inference that he was indifferent. That is to say, repeating an analysis which has been gone through with before, it means that the law, applying a general objective standard, determines that, if a man makes a statement on those data, he is liable, whatever was the state of his mind, and although he individually may have been perfectly free from wickedness in making it.
      2. *Derry v. Peek*, 14 App. Cas. 337, 374 (1889)
         a. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. . . . Although I have treated the second and third as

distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states . . . . Thirdly, if fraud be proved, the motives of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

(Brief author's note: Unlike Holmes' definition which is clearly objective, Derry v. Peek is objective for the purposes of this brief because knowing conduct has been specifically identified, and the general qualifying statement that intent to cheat does not matter. Whatever the classification of "without belief in the truth" may be, this brief assumes it is not subjective.)

2. Recklessness as to consequences
   a. Subjective standard
      1. *Restatement of Torts* (1939) § 500, at 1293-1295
         a. § 500, Reckless Disregard of Safety
            1. The actor's conduct is in reckless disregard of the safety of another if he intentionally does an act or fails to do an act which it is his duty to the other to do

knowing or having reason to know of facts which would lead a reasonable man to realize that the actor's conduct not only creates an unreasonable risk of bodily harm to the other but also involves a high degree of probability that substantial harm will result.

b. Comments to § 500

1. Comment b, Perception of risk

a. Conduct cannot be in disregard of the safety of others unless the act or breach of duty is itself intended, notwithstanding that the actor knows of facts which would lead any reasonable man to realize the extreme to which it subjects the safety of others.

2. Williams & Hepple, *Foundations of the Law of Torts* (1976)

a. If it is neither desired nor foreseen as certain, but is nevertheless foreseen as possible, and if the actor is not justified in running such a risk, the conduct is said to be reckless as to consequence.

3. Harper and James, *Law of Torts* (1956) at 533

a. But the intent to deceive is present when a defendant makes a statement which he knows to be false or which he does not know to be true, for the purpose of inducing the plaintiff to act in reliance upon the truth.

4. Keeton, P., *Fraud: The Necessary Intent to Deceive*, 5 U.C.L.A. L. Rev. 583, 592 (1958)

a. The jury can be told that if the defendant made a positive and unqualified representation as to the existence of a particular fact, and did so actually realizing that the information relied upon was inadequate and insufficient to justify a feeling of certainty about it, then they must find that the representation was fraudulently made.

b. I suggest that this is actually a much more understandable proposition than the often used formula of Derry v. Peek.

b. Objective standard

1. Prosser, *Law of Torts* (4th ed. 1971) at 185

a. The usual meaning assigned to "wilful", "wanton", or "reckless", according to taste as to the word

used, is that the actor has intentionally done an act of an unreasonable character in disregard of a risk known to him or so obvious that must be taken to have been aware of it, and so great as to make it highly probable that harm would follow. It is usually accomplished by a conscious indifference to the consequences, amounting to willingness that they shall follow; and it has been said that this is indispensable.

3. Substantially certain consequences
   a. Prosser, *Law of Torts* (4th ed. 1971) at 31-32
      1. Intent, however, is broader than a desire to bring about physical results. It must extend not only to those consequences which are desired, but also to those which the actor believes are substantially certain to follow from what he does.
      2. Apparently, the line (between intent and negligence) has been drawn by the courts at the point where the known danger ceases to be only a foreseeable risk which a reasonable man would avoid, and becomes a substantial certainty.

C. Criminal Law.

1. Gross negligence
   a. Cross and Jones, *Introduction to Criminal Law* (6th ed. 1968) at 44.
      1. Senses of recklessness
         a. "Recklessness" is used in two senses. In the first (subjective) sense, it means the conscious taking of an unjustified risk.
      2. Objective sense
         a. In the second (objective) sense "recklessness" means conduct which in fact involves an unjustified risk, whether the agent knows the risk or not.

            In its second sense, "recklessness" is the equivalent of gross negligence, . . . The risk must have been avoided by the exercise of slight care.

2. Recklessness as to circumstances
   a. Williams, *The Criminal Law* (2nd ed. 1961) at 148-149
      1. Involves knowledge of the circumstances, or of the possibility of the circumstances. It occurs where there are some circumstances, specified by law as part of the actus reus, which the actor does not positively know to be present in his own case, but which he consciously takes the risk of being present.

2. A good example is deceit or fraud. This can be committed intentionally or recklessly: intentionally where the falsity of the statement is known, recklessly where the falsity is not positively known but where the utterer does not know whether the statement is true or false. The leading authority is *Derry v. Peek* (1889).
3. The element common to the two kinds of recklessness is the conscious taking of a risk. The presence or absence of the fact (the consequence or circumstance) is not part of the actor's purpose, but he chooses to ignore the possibility of the fact in order to pursue his purpose.

3. Recklessness as to consequence
   a. Williams, *The Criminal Law* (2nd ed. 1961) at 53, 58, 62 and 63
      1. Occurs when the actor does not desire the consequence, but foresees the possibility and consciously takes the risk.
      2. Occurs where the consequence is foreseen not as morally or substantially certain but only as "probable" or "likely," or perhaps as "possible."
      3. It (recklessness) is like intention in that the consequence is foreseen, but the difference is that whereas in intention the consequence is desired, or foreseen as a certainty, in recklessness

it is foreseen as possible or probable but not desired.

4. Recklessness is a branch of the law of negligence; it is that kind of negligence where there is foresight of consequences. The concept is therefore a double barreled one, being in part subjective and in part objective. It is subjective in that one must look into the mind of the accused in order to determine whether he foresaw the consequence. If the answer is in the affirmative, that is the end of the subjective part of the enquiry and the beginning of the objective part. One must ask whether in the circumstances a reasonable man having such foresight would have proceeded with his conduct notwithstanding the risk. Only if this second question, too, is answered in the affirmative is there subjective recklessness for legal purposes. If the first requirement is negatived one may still proceed to ask the second question, but the result can only be to establish inadvertent negligence.
   a. Consequences may range in every degree from the remote and unexpected, through the reasonably possible, the likely or probable, to the inevitable.
   b. The conclusion is that knowledge of bare possibility is suf-

ficient to convict of recklessness if the conduct has no social utility, but that the slightest social utility of the conduct will introduce an enquiry into the degree of probability of harm and a balancing of this hazard against its social utility. If this is the law, it would be useless to define probability in mathematical terms, because the degree of probability that is to constitute recklessness must vary in each instance with the magnitude of the harm foreseen and the degree of utility of the conduct.

c. The subject theory of recklessness requires that the defendant should have foreseen the degree of probability of the consequence which is held to make the act reckless.

d. Thus the extent of probability of damage is a subjective question, dependent on the foresight of the accused; yet the social desirability of the risky conduct, and the question whether it balances the foreseen danger, are objective questions to be judged by the standard of the reasonable man.

e. It must be admitted that this makes the enquiry into reckless-

ness even more abstruse than it has appeared before. Degrees of possibility or probability, in the circumstances that come before the courts, are almost incommunicable, except in rough terms. Even if they were communicable, it would often be difficult to prove against a defendant the precise degree of his foresight. In practice, a defendant may find himself judged by the standard of what a reasonable man would have foreseen, even though this standard may sometimes result in the conviction of one who was not reckless in fact. The finding of recklessness is easiest where the defendant was bent upon wrongdoing, and pursued his aim regardless of an obvious risk; such a defendant can be accounted reckless because he was not entitled, for the sake of his unlawful ends, to inflict *any* foreseen risk upon others. His plea that he thought the risk a small one will not avail him, because he was not entitled to bring others even into small danger for an unlawful purpose of his own.

b. Le Fave and Scott, *Criminal Law* (1972) at 215-216

1. Recklessness vs. Intention and Knowledge
    a. We have seen that crimes defined so as to require that the defendant intentionally caused a forbidden bad result are usually interpreted to cover one who knows that his conduct is substantially certain to cause the result, whether or not he desires the result to occur. "Recklessness" in causing a result exists when one is aware that his conduct might cause the result, though it is not substantially certain to happen. . . . . (T)hus while "knowledge" and knowing-type of intent require a consciousness of almost-certainty, recklessness requires a consciousness of something far less than certainty or even probability.

c. *Model Penal Code*
    1. § 2.02(2)(c) (T.D. No. 4 p. 13)
        a. A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the mental element will exist or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct

and the circumstances known to him, its disregard involves culpability of high degree.

4. Wilful blindness
    a. Williams, *The Criminal Law* (2nd ed., 1961) at 157-159
        1. To the requirement of actual knowledge there is one strictly limited exception. Men readily regard their suspicions as unworthy of them when it is to their advantage to do so. To meet this, the rule is that if a party has his suspicions aroused but then deliberately omits to make further inquiries, because he wishes to remain in ignorance, he is deemed to have knowledge.
        2. In other words, there is a suspicion which the defendant deliberately omits to turn into certain knowledge. This is frequently expressed by saying that he "shut his eyes" to the fact, or that he was "wilfully blind."
        3. There must have been something to put the accused on inquiry. Hence, . . ., it was held to be wrong to direct the jury that if a man is reckless and does not care, he is just as guilty as if he received the property, knowing at the time that there was something wrong with it. Recklessness and "not caring" are not quite the same thing as wilful blindness; such words express the latter doctrine too widely.

Relationship of Classification to Definition.

It is evident from the outline that the definition of recklessness in Rule 10b-5 matters is determined by whether the conduct is labeled as deceit, *i.e.*, recklessness as to circumstance/reckless disregard for the truth, or whether the conduct is labeled as other than deceit, *i.e.*, recklessness as to consequence.

The importance of *Affiliated Ute* is that the decision practically mandates all Rule 10b-5 matters to be considered as deceit cases. By funnelling all the facts through a "failure to disclose" test if the facts are not clearly deceit facts, the decision locks in the recklessness as to circumstance notion, regardless of whether the *Affiliated Ute* decision itself logically follows from the cases which purportedly underpin it.

Another consideration is whether the notion of recklessness as to circumstance applies at all in the securities fraud context. Unlike common law deceit cases, the claim for relief in Rule 10b-5 matters is based on fraud or deceit in connection with the purchase or sale of a security. Common law deceit focuses on the misrepresentation regardless of the context. Consequently, the sweep of recklessness as to circumstances is much narrower than recklessness as to consequence. A better way of putting it is that recklessness as to circumstance is recklessness as to consequence where the consequence is deceit. In Rule 10b-5 matters, the consequence prohibited is securities fraud, not merely a misrepresentation. Hence, recklessness as to consequence is a preferable general rule, and recklessness as to circumstance is not applicable regardless of its historical application in common law deceit cases.

The relationship of classification to definition is best typified by the definition of recklessness found in the *Franke* case. The fraud is classified as an "omission," and consequently recklessness is applied to reckless conduct in an omissions case. Consequently, if the "omissions" concepts are unsound, so too is the related definition of reckless conduct.

Subjective vs. Objective.

Professor Williams in *The Mental Element in Crime* (1965) at p. 57 states:

> On the issue of recklessness, the question is whether the facts speak so loudly that the jury can profess themselves satisfied beyond a reasonable doubt that the defendant must have foreseen—that they cannot imagine that he did not foresee—the possibility of the consequence.

And at 71, he states:

> On the issue of recklessness, the question is whether the accused person—the very man before the court—foresaw the consequence. The jury may consider whether the accused must have foreseen the consequence—meaning, did foresee it. It would even be permissible to consider whether the accused must as a reasonable (*i.e.*, sane) man have foreseen the consequence. But this formula needs to be understood, for it should not be confused with the question whether the accused *ought* as

> a reasonable man to have foreseen the consequence —which is a question not of recklessness but of negligence.

Professor Prosser at 31-32 states regarding extending intent to consequences which the actor believes are substantially certain to follow from what he does:

> The practical application of this principle has meant that where a reasonable man in the defendant's position would believe that a particular result was substantially certain to follow, he will be dealt with by the jury, or even by the court, as though he had intended it.

It is true the distinction is a subtle one. Professor Williams states at 57:

> Generally, the only way of establishing recklessness is to show that the consequence was so obvious that anyone with a grain of sense must have foreseen it. If the defendant was grossly negligent, we may be driven to the inference that he foresaw the risk, so it may be contended that the two questions merge.

Consequently, Professors Prosser and Williams generally agree on the subjective nature of recklessness. The difficulty observed by both is that in practice the distinction is subtle when it comes to judging the subjective element, although as Professor Williams cautions the distinctions should be preserved.

The *Sundstrand* decision illustrates another problem relative to the subjective-objective dichotomy. The *Sundstrand* definition emphasizes the objective nature of recklessness, *i.e.*, highly unreasonable omission. The Seventh Circuit equated this external standard with intent, but did not address the subjective nature of

the same definition which required knowledge of the danger of misleading or obviousness that the actor must have been aware of it. Such an oversight encourages the objective practical application suggested by Professor Prosser.

The result of *Sundstrand* was the regression back to "should have known" language under the guise of recklessness, although on its face it is clearly negligence terminology. Therefore, in this subtle as well as complex area, the importance of definition ought not to be forgotten.

Degree of Probability of Consequence.

Professor Williams and Professor Prosser differ as to the required probability of consequence required to establish recklessness. Professor Prosser requires substantial certainty. Professor Williams in The Criminal Law (2d ed. 1961) at 62 states:

> . . . (t)he degree of probability that is to constitute recklessness must vary in each instance with the magnitude of the harm foreseen and the degree of utility of the conduct.

This brief leaves this question open, but given that there are varying conceptions of recklessness, the question is relevant to any consideration of recklessness.

Conclusion.

Since *Affiliated Ute* influences the classification of securities fraud cases, it is important to ascertain whether its view is theoretically sound. This is a prerequisite to examining the question of the applicability of recklessness as a form of scienter in securities fraud law. The view of this brief is that it is not theoretically sound, unless the fictions the decisions established were intended.

If the views of *Affiliated Ute* suggested by this brief are endorsed, then the following questions relative to recklessness ought to be answered:

1. Is recklessness subjective or objective?
2. Is recklessness as to circumstance applicable to Rule 10b-5 matters?
3. Is recklessness as to consequence applicable to Rule 10b-5 matters?

This brief has suggested the following:

1. Recklessness is subjective.
2. Recklessness as to circumstance is inapplicable to Rule 10b-5 matters.
3. Recklessness as to consequence is applicable to Rule 10b-5 matters.

Respectfully submitted,

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Service of the within and receipt of a copy thereof is hereby admitted this ..... day of October, A.D. 1978.

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